12/10/86 R5650-2

JAPAN · ECONOMIC · INSTITUTE

JEI REPORT

NO. 44B
December 5, 1986

IN THIS ISSUE:

Report On Economic Restructuring Stresses Employment Measures 1

LDP Wrestles With Tax Reform 2

Komeito's Takeiri Resigns 4

Changes In Key Senate Committees 5

Japan Agrees To Restrain Machine Tool Exports 6

Notes: Sumitomo-Goldman, Sachs 8

Corrections 9

Report On Economic Restructuring Stresses Employment Measures

A report released by a government advisory council December 1 called for industrial restructuring and continued economic growth to trim Japan's huge trade surplus and improve the quality of life. It also emphasized, though, the importance of measures to insure sufficient employment opportunities during the restructuring, reflecting the government's concern over rising unemployment figures. Bunpei Otsuki, chairman of the Japan Federation of Employers' Associations, warned recently that the unemployment rate will climb from September's 2.8 percent to the 6-7 percent range if current trends continue.

The advisory council, chaired by former Bank of Japan governor Haruo Maekawa, prepared the study as an extension of the Maekawa report submitted to the prime minister April 7 (see JEI Report No. 14B, April 11, 1986). The council's final recommendations will be submitted next spring.

to threaten to filibuster any trade bill that did not limit textile-apparel imports. Having already proclaimed trade as a priority for the Commerce Committee, the senator is likely to emphasize textile legislation, but will probably not limit himself to that issue. Some observers are predicting that he may even attempt to inaugurate a rivalry with the Finance Committee for jurisdiction on trade matters, similar to the House competition between Ways and Means trade subcommittee chairman Sam Gibbons (D, Fla.) and Energy and Commerce chairman John Dingell (D, Mich.).

On the other side of Capitol Hill, House members are gearing up to renew their drive for a trade bill. Rep. Jim Wright (D, Tex.), the new Speaker of the House, has said that a modified version of HR 4800 will be introduced January 6 -- the day Congress convenes -- as HR 3. Preliminary indications are that the House and Senate are working independently on trade legislation; the lack of communication between the two chambers may pave the way for a protracted conference later in the session. For its part, the administration has not said whether it plans to cooperate with Congress and all indications are that legislators are forging ahead without close White House consultations.

Eileen Marie Doherty

Japan Agrees To Restrain Machine Tool Exports

Another item can be crossed off the list of outstanding bilateral trade issues. On November 20 trade negotiators for Japan and the United States initialed an agreement limiting U.S.-bound shipments of six lines of Japanese-made machine tools for five years effective January 1, 1987. The restraint arrangement's final details were worked out six months to the day after President Reagan took the unprecedented step of asking Japan and three other foreign suppliers (West Germany, Switzerland and Taiwan) to voluntarily restrict machine tool exports for national security reasons (see JEI Report No. 20B, May 23, 1986). By coming to terms with Washington just before the White House deadline for an agreement, Tokyo avoided a threatened formal finding under Section 232 of the 1962 Trade Expansion Act that imports of machine tools from Japan undermine the viability of an industry essential to this country's security and the accompanying presidential decision to roll back shipments by bigger margins than the negotiated cutbacks.

The details of the restraint arrangement with Japan are still confidential, mainly because a final agreement has not been signed but also because negotiations with the three other suppliers targeted by the administration are continuing. From press leaks on both sides of the Pacific, however, it is possible to piece together a fairly complete picture of the pact. According to this information, Tokyo will cap 1987 shipments of machining centers at 2,800 units (down 22.3 percent from 1985 exports), computer numerically controlled lathes at 3,200 units (down 16.5 percent) and CNC punching and shearing machines at 250 units (a cut of roughly 40 percent).

With exports held at these volumes, government and industry analysts project that Japan's share of the U.S. market for high technology machining centers and CNC lathes will return to the 1981 level -- the last big-profit year for the boom-and-bust domestic machine tool industry. For machining

centers this would mean a rollback in market penetration from 1985's 73.5 percent to 51.5 percent and for CNC lathes a cut from 67.1 percent to 57.5 percent. Washington also expects shipments of CNC punching and shearing machines in 1987 to be equivalent to 1981's market share of 19.3 percent or well below the 1985 figure of 43.1 percent.

In the three other product lines covered by the restraint agreement -- manual lathes, manual punching and shearing machines and milling machines, the Ministry of International Trade and Industry will monitor exports destined for the United States. The apparent objective here is to keep 1987 deliveries close to the volumes shipped in 1985 (see Table). In that year Japanese suppliers controlled less than 10 percent of the American market in each of the three lines.

Japan's Exports of Selected Machine Tools to the United States, 1981-85

	1981	1982	1983	1984	1985
Quantity (units)					
Machining Centers	2,180	1,728	1,957	2,858	3,602
Numerically Controlled Lathes	3,878	2,350	1,781	3,201	3,834
Other Lathes	642	449	200	254	331
Numerically Controlled Milling Machines	364	184	180	240	254
Other Milling Machines	495	1,693	1,570	2,416	2,168
Shearing and Punching Machines	1,462	1,040	2,369	2,855	2,559
Value (thousands of dollars*)					
Machining Centers	$222,164	$165,897	$170,581	$254,979	$313,498
Numerically Controlled Lathes	315,673	178,490	114,919	192,570	227,341
Other Lathes	22,444	18,228	5,250	6,515	2,801
Numerically Controlled Milling Machines	26,907	10,751	8,178	29,366	30,504
Other Milling Machines	11,456	5,697	1,994	4,010	2,981
Shearing and Punching Machines	34,230	21,275	21,006	31,549	39,254
Total	632,874	400,338	321,928	518,989	616,379

*The following average annual exchange rates, calculated by the Ministry of Finance, were used to convert the yen export figures: 1981, Y219.90; 1982, Y248.33; 1983, Y237.52; 1984, Y236.95; and 1985, Y240.29.

Source: Japan, Ministry of Finance, Japan Exports and Imports: Commodity by Country

There are reportedly no numbers in the pact for exports of machining centers, CNC lathes and CNC punching and shearing machines after 1987. This fall U.S. trade negotiators indicated that the restraint levels would be adjusted at least annually and perhaps quarterly based on projections of

apparent domestic consumption. If this information is correct, the machine tool arrangement will work like the one governing Japan's U.S.-bound exports of steel mill products (see JEI Report No. 11B, March 22, 1985). In short, shipments in the agreement's out years could be higher or lower than in 1987.

Another question mark is the treatment of machine tool parts shipped to the United States for assembly by the growing number of Japanese builders with American plants. What Japan classifies as kits or knocked-down machines in its export statistics are definitely subject to the shipment ceilings since they are viewed as no different than finished products. But with the U.S. assembly operations of Japanese companies incorporating more domestic parts and components in their machine tools in response to the strong yen, these products might be treated as American-made and placed outside the export limits.

The uncertainty about this and some other details is one reason industry reaction to the agreement has been so muted, both here and in Japan, but there are more basic explanations. Japanese machine tool builders were reconciled to export limits of one kind or another once President Reagan made the decision to help the struggling U.S. industry; since the only alternative to "voluntary" restraints was a 232 finding, they were relieved that Tokyo and Washington came to terms. The fact that the agreement is not retroactive to May or even the beginning of 1986 -- a surprising administration concession -- also made the settlement option more acceptable to the Japanese industry.

At first glance, the low-key response of U.S. machine tool companies to the prospect of five years of controlled competition from their primary rivals is more puzzling than the subdued protest from Japanese suppliers since domestic builders have been trying to gain import relief for the last four years. Here, too, there is a straightforward explanation. Industry executives and congressional supporters of protection for machine tool makers maintain that the restraint arrangement is a case of too little, too late (see JEI Report No. 31B, August 22, 1986).

Susan MacKnight

Notes

• On November 19 the U.S. Federal Reserve Board approved Sumitomo Bank, Ltd.'s purchase of a minority interest in Goldman, Sachs & Co.'s profits with some restrictions. The Japanese bank sought to invest $500 million for a non-voting position in Wall Street's largest independent brokerage house, giving it a 12.5 percent stake in Goldman, Sachs' annual profits by 1988 (see JEI Report No. 41B, November 7, 1986). The Fed governors, however, were concerned that this would give Sumitomo undue influence over Goldman, Sachs' activities, noting that "The total investment would exceed 25 percent of Goldman's total equity," which was approximately $1.3 billion at the end of May 1986.

Therefore, the Fed placed the following restrictions on the agreement: Sumitomo's total investment will be limited to 24.9 percent of the total partners' equity; Sumitomo will not acquire any Goldman stock or have any representatives on the board of directors; the two will conduct business

relations at arm's length; furthermore, they will not increase their mutual business dealings and will not solicit business for each other; no employee exchanges will be allowed; and Sumitomo must "enhance its capital position by an amount that will substantially offset the funds being invested in Goldman, Sachs." The two will refrain from establishing joint ventures in London and Tokyo for now.

Despite these restrictions, both firms accepted the Fed's ruling. A senior partner at the American brokerage concern said that the firm would try to raise its partners' equity enough to allow Sumitomo to invest the full $500 million by 1988. The president of Sumitomo took a long-term view, saying that he hoped that some of the restrictions would be eased in the future. The two sealed the agreement on November 28 as planned.

Corrections

In JEI Report No. 39A, October 24, 1986, it was incorrectly reported that Japan's official development assistance was increased by 10 percent in the FY 1986 budget. Budget guideline figures slated a 10 percent hike, but the final budgetary figure was 7 percent.

* * * * * *

The views expressed in this report are those of the authors and do not necessarily represent those of the Japan Economic Institute.